# Institutional Risk

*Our agenda is clear. The global war on terror is continuing, and it will for the foreseeable future. As we prosecute the war, we'll need to continue to strengthen, improve and transform our forces; modernize and restructure programs and commands . . . streamline DOD processes and procedures.*

*Secretary of Defense Donald H. Rumsfeld*
*January 6, 2004*

| | |
|---|---|
| **Streamline the Decision Process, Improve Financial Management, and Drive Acquisition Excellence** | **Manage Overhead and Indirect Costs** |
| **Improve the Readiness and Quality of Key Facilities** | **Realign Support to the Warfighter** |

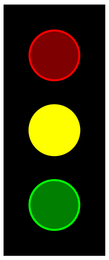
Just as we must transform America's military capability to meet changing threats, we must transform the way the Department works and on what it works.

Our leaders cannot act wisely unless they can get the information they need, at the right time. We must drive a better understanding of how overhead and indirect costs relate to military capability—we must build a base of facilities that are ready and able to meet the highest standards for quality and readiness.

Finally, we continue to transform our military and civilian forces to embrace new ways of working, and to pursue creative technology solutions.

The Secretary's performance priorities for institutional risk in FY 2005 are *Streamline DoD Processes* and *Reorganize DoD to Deal With Pre-War Opportunities and Post-War Responsibilities.*

# STREAMLINE THE DECISION PROCESS, IMPROVE FINANCIAL MANAGEMENT, AND DRIVE ACQUISITION EXCELLENCE



*Waste drains resources from training and tanks, from infrastructure and intelligence, from helicopters and housing. Outdated systems crush ideas that could save a life. Redundant processes prevent us from adapting to evolving threats with the speed and agility that today's world demands.*

*Secretary of Defense Donald H. Rumsfeld*
*September 10, 2001*

After Secretary Rumsfeld announced his intention to transform how the Department does business, we have fundamentally redesigned the way in which we think and act as a management team:

- The acquisition process is benchmarking itself against the private sector,
- Our financial systems are being entirely overhauled both to address long-standing deficiencies and to leverage new technology, and
- Internal decision processes are undergoing the first major reform since the introduction of the planning, programming, and budgeting system in the 1960's.

Of course, such change does not matter unless it produces results – unless it makes us better able to support the warfighter and provide for national security. That is why across the Department – from our underlying financial systems to our military departments and defense agencies– we are committing to specific, measurable performance goals to track our progress toward achieving the transformation challenge set out by Secretary Rumsfeld the day before September 11th.

## Streamline the Decision Process

### THE PRESIDENT'S MANAGEMENT AGENDA (PMA)

*Perhaps no other Department has been more directly affected by the events of September 11th, than Defense . . . we have responded to and continue to prosecute a war against our enemies half a world away . . . we are undergoing transformational changes on a scale unprecedented in the history of this Department . . .*

*Under Secretary of Defense for Personnel and Readiness David S. C. Chu*
*September 1, 2002*

The President's Management Agenda highlights five government-wide initiatives to improve management and service to our citizens. They are: Strategic Management of Human Capital, Improved Financial Performance, Competitive Sourcing, E-Government, and Budget and Performance Integration. When the PMA was first announced in 2001, the Department was rated "red" in all five initiative areas. Within two years, we have improved our rating to "yellow" for three initiatives, and are rated "green" for progress in all five areas.

- ***Strategic Management of Human Capital***. We are continuing to refine and manage by our comprehensive civilian human resource strategic plan, which directly correlates to the government-wide PMA goals. During FY 2003, we completed development of 43 (out of 44 planned) performance measures for human resource management. We also became the first federal agency to offer "live" advice for finding a job in the Department of Defense via a toll-free number (1-888-DoD-4USA), TTY number (703-696-5436), and a dedicated website at www.Go-Defense.com. This year, Congress approved the National Security Personnel System, an historic transformational initiative to introduce 21st century, information-age best practices to the Department. Chief among these is the alignment of the human resource system with defense mission objectives, the agility to respond to new business and strategic needs, and simplification of administrative processes. Implementation has begun and will continue through FY 2005.

- ***Improved Financial Management***. Last year, we made greater progress in addressing the challenge of improving financial management than in any other year since passage of the Chief Financial Officers Act. Senior defense managers are collaborating with their counterparts at the Office of Management and Budget, the General Accounting Office, and the Inspector General to resolve the 11 material control weaknesses that most affect our ability to obtain a clean audit opinion.

- ***Competitive Sourcing***. By the end of FY 2003, we completed initiatives on approximately 78,000 FTEs are continuing competition on an additional 18,000 positions. The FY 2005 budget will set incremental targets for each military service and defense agency toward achieving the Business Initiative Council management initiative goal of competing 226,000 defense positions by FY 2009.

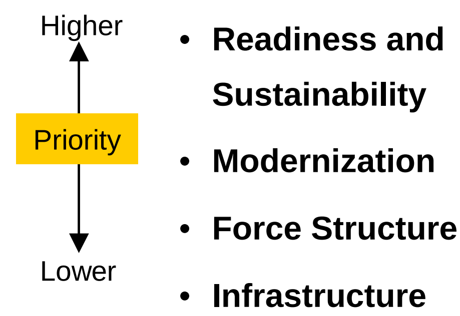
- ***E-Government***. Of the 25 initiatives identified by the President's Management Council for e-Government improvements, 18 involve defense. Accordingly, we have taken an active, leading role in many of those initiatives. During FY 2003, all 162 defense business cases for information technology submitted for review to the Office of Management and Budget were rated "acceptable." The National Archives and Records Administration endorsed our records management standard and the Defense Financial Accounting System was selected as one of the government-wide federal payroll providers.

- ***Budget and Performance Integration***. We are in the midst of a defense-wide effort to identify and use meaningful performance metrics to better manage and justify program resources. In FY 2003, the Department's annual report to the President and Congress described the leading performance goals (and associated performance measures) used to evaluate risk (www. defenselink.mil/execsec/2003adr). The FY 2005 defense budget will include some performance-based metrics – and we are actively integrating performance information and metrics into all phases of the Department's revised program and budget process. During the development of both the FY 2004 and FY 2005 President's Budget, the Department participated in the program evaluations conducted by the Office of Management and Budget via the Program Assessment Rating Tool.

Details and summary discussions for each PMA initiative are available at: [www.results.gov](http://www.results.gov).

### INCREASE THE VISIBILITY OF TRADE SPACE

Section 113 of Title 10, U.S. Code, requires the Secretary of Defense to give military departments and defense agencies written policy guidance on how to prepare their programs and budgets. This guidance must include *"… national security objectives and policies; the priorities of military missions; and the resource levels projected to be available for the period of time for which such recommendations and proposals are to be effective."*




Too often in the past, the program priorities highlighted in the Secretary's guidance were unaffordable when taken together. Two years ago, Secretary Rumsfeld directed his senior aides to completely rethink how defense guidance was drafted. He asked them to use the document to define "trade space" that would help him balance investment—and risk—across the entire defense program.

This year's Strategic Planning Guidance dramatically improves the Secretary's ability to shape the investment choices made by the military departments and defense agencies by assigning specific priorities that have to be achieved within fiscal constraints and identifying areas for accepting increased risk or divesture, as required to stay within those constraints. It also directs several analytic efforts be undertaken during the remainder of FY 2004 and in FY 2005 to gain insight into how programs must be structured to achieve synergy in joint operations, and how performance metrics can be better defined to help evaluate programs in a joint context. Many of these analyses are continuations or redirections of on-going work. Others are new and robust, quick-turn studies that are underway to help make earlier decisions on programmatic matters apply to a joint, capabilities-based approach. The Joint Programming Guidance, published this Spring, reported the findings of these studies and described specific program changes and priorities to guide the FY 2006 President's Budget and FY 2006-FY 2011 Future Years Defense Program.

### Improve the Transparency of Component Submissions

Accurate information is the keystone of good decisions. Accordingly, we are committed to integrating the program and budget databases maintained by the military departments and defense agencies. This would allow "transactional" updates to the common defense program or budget position. This will speed processing and streamline workload associated with developing the defense program and budget. It also will make timely, accurate data more readily available to decision makers for review and analysis.

We are on track to converting to a completely transactional data collection process by FY 2007. This year, we streamlined and combined both the program and budget review process, cutting individual decision documents that had to be reviewed by almost a third over FY 2003. The FY 2005 defense budget is the first that reflects our commitment to a 2-year budgeting process in the Department of Defense– so that the hundreds of people who invest time and energy to rebuild major programs every year can be freed up to focus more effectively on implementation. Because the FY 2005 defense budget is, in effect, the second installment of funding for the priorities set out in the President's 2004 request, we made changes to just 5 percent of the Department's high-interest and must-fix issues – and *then* only when the costs of the changes could be offset by savings elsewhere in the budget.

### Provide Explicit Guidance for Program and Budget Development

Section 113 of Title 10, U.S. Code, requires the Secretary of Defense to give the heads of the components the resource levels projected to be available for the period of time for which national security objectives and policies and military missions established as priorities under the defense strategy are to be effective. In the past, the assumptions used to set these resource controls were not shared with component organizations. Beginning with the first Strategic

Planning Guidance, we established shared assumptions about key resource planning factors with all of the Department's resource and budget planners. We then defined those program areas where planners should either accept or decrease risk, as defined under the Department's risk management framework.

This approach will provide continuity and give us an opportunity to collect and evaluate lessons-learned from actual performance results. For example, military departments and defense agencies could not make major changes from the approved FY 2004 defense baseline for FY 2005 absent an explicit rationale that considered actual performance results. During FY 2005, program plans (and budget proposals) will be closely scrutinized to ensure they directly align with the strategic outcomes directed in the Secretary's Strategic Planning Guidance, and conform to the specific program performance goals outlined in the Joint Program Guidance.

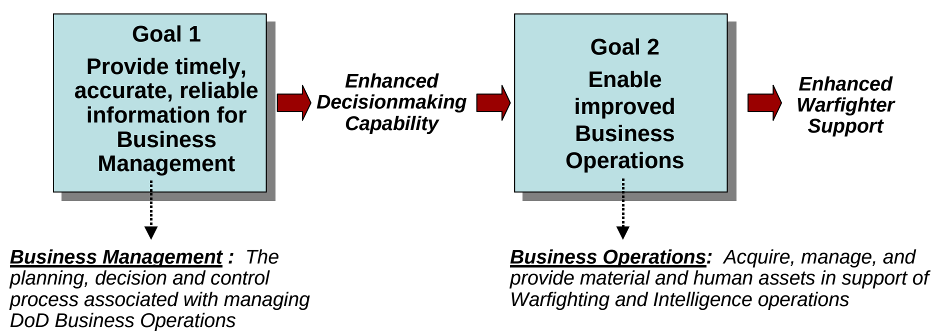
## Improve Financial Management

Last year, we began to define and use a balanced scorecard for financial management to track progress toward achieving a variety of defense business and financial management reforms and enhancements. Similar to the force management scorecard used by the Under Secretary of Defense for Personnel and Readiness, the Department's Chief Financial Officer will use the financial management scorecard to realign financial activities of the military departments and defense agencies. Accordingly, we have retired the "Implement Realignment Recommendations Approved by the Senior Executive Counsel" measure and replaced it with the new measures described below.

### MODERNIZE CURRENT FINANCIAL OPERATIONS

During FY 2003, we completed work on the Department's business enterprise architecture. This new architecture, which incorporates best practices from both the public and private sector, covers both business processes directly associated with financial management and the hundreds of associated processes that support budget formulation, acquisition, inventory management, logistics, personnel, and property management. It is one of the most ambitious enterprise architectures ever attempted to date, building end-to-end business process models that define capabilities, data ownership, information flows, and unique responsibilities within the business domains of the Department.

Throughout FY 2004, we will update the architecture, releasing versions 2.0 through 2.2. Each version will further enhance our capability to achieve unqualified audit opinions by adding more explicit business rules and processes. Version 3.0 is scheduled for release in the third quarter of FY 2005, and will address integrated planning, programming, budgeting and execution; expanded human resources management improvements; and integrated life-cycle materiel management.




ADDRESS FINANCIAL MANAGEMENT CHALLENGES

In January 2003, the General Accounting Office cited the need to find and fix decades-old financial management problems as one of the Department's top 10 management challenges. We agree that we have taken on a huge challenge to control costs, ensure basic accountability, maintain funds control, and prevent fraud. Our first step has been to identify and act to resolve financial material weaknesses highlighted by the Inspector General in their review of our annual financial statements.

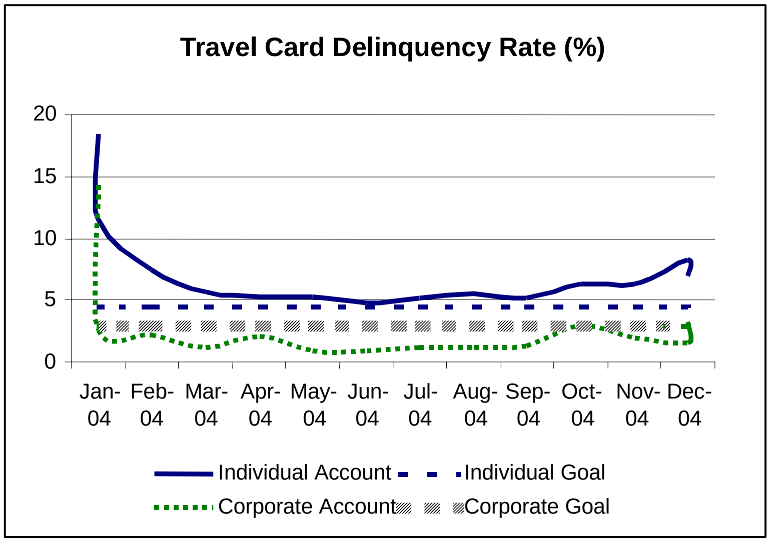
Our long-term goal is to improve reporting enough each year so that by FY 2007 we are able to obtain a favorable audit opinion. Two years ago, in FY 2002, defense auditors highlighted 13 financial statement weaknesses. Two of these weaknesses were corrected in fiscal year 2003. We expect to resolve an additional weakness by completing a full inventory of ranges and other activities that contribute to environmental liabilities during FY 2004. By the end of FY 2005, we expect to retire five more weaknesses, to include clearing up differences between our records and the Department of Treasury regarding cash accounts.

For a complete description of remaining financial weaknesses and the status of proposed resolutions, see our FY 2003 Performance and Accountability Report at www.defenselink.mil/comptroller/par.

### IMPROVE PERFORMANCE FOR RECURRING FINANCIAL TASKS

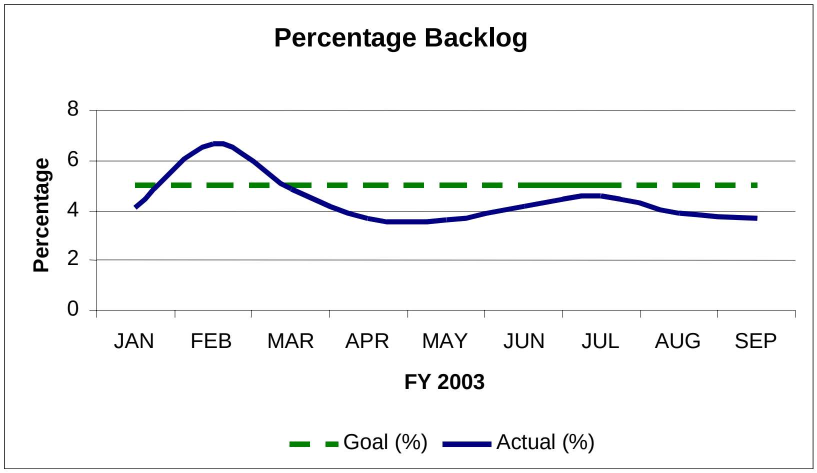
Even as we re-engineer our overall technology and management practices, there are many routine accounting or financial tracking tasks that can be improved by increased oversight. Accordingly, we are developing specific performance measures for four activities that directly contribute to existing material weaknesses identified by the Inspector General (see discussion, above):

- ***Travel Charge Card Delinquencies***. In January 2001, delinquency rates (more than 60 days past due) for government credit cards issued individually to military and civilian workers were reported as high as 18 percent, and as much as 14 percent for cards issued to organizations. Subsequently we undertook a major initiative to cut abuses, and by the end of October 2003, delinquency rates for individual credit card holders fell to 6.3 percent, and to 3 percent for organizational cardholders. During the same time period, we recovered approximately $42M in debts, and cancelled more than 500,000 cards that had been inactive for 12 months or more. Reports for March through September 2003 indicate that less than 2 percent of all government cardholders are delinquent. During FY 2005, we will use data mining to identify patterns of credit card abuse, strive to reduce the delinquency rate to less than 4.5 percent of dollars and less than 2 percent of all cardholders.




- ***Erroneous Payments***. The Improper Payments Information Act requires federal agencies to report payments that should not have been made or that were made in an amount different than that required by law, regulation, or contract. During FY 2003, the Department identified $53.5 million of improper payments related to the military health program – this represents an error rate of 1.36 percent of the $3.9 billion in benefit program payments made that year. For military retirement, we identified $33.1 million of improper payments – an error rate of 0.10 percent of the $32.7 billion program. During FY 2005, we will attempt to identify which programs and activities are most susceptible to significant improper payments, and subsequently establish goals to reduce or eliminate their frequency.

- ***Late Payments of Commercial Invoices***. It is important the government pay its bills on time. In turn, the military services and defense agencies must pay all invoices on or before their due date. Accordingly, the Comptroller has entered into partnerships with the military services and defense agencies so that electronic commerce can be leveraged to more quickly process invoices and receive reports. By the end of FY 2003, the backlog of commercial invoices declined by 28 percent. Our goal for FY 2005 is for not more than 2 percent of all commercial invoices on hand will be paid late.




- ***Fund Balance with the Department of Treasury***. Each month, the Department reconciles monies to be spent against the transactions authorized in the defense appropriation and authorization acts for that fiscal year. We must research and resolve all differences between our accounts and those held by Treasury. Differences that are not cleared during the next accounting month are carried forward to subsequent months until cleared. Our goal is to be able to reconcile 95 percent of all general ledger account appropriations and accounts (current, expired, and no-year) by fiscal year 2007. During FY 2003, the Department reconciled 92 percent of selected agency ledger account balances. During FY 2005, we will research ways to measure our progress toward reconciling the remainder of the accounts.

## Drive Acquisition Excellence

*For acquisition [transformation] this translates to things like reducing cycle times to accelerate technology to the warfighter, demanding modular system architecture and open system software to provide for rapid insertion of evolving technology, specifying tough logistics requirements to limit footprint and a focus on thorough contracting . . .*

*Acting Under Secretary of Defense Michael W. Wynne*
*July 22, 2002*

The Department's seven goals for acquisition transformation are: (1) acquisition excellence with integrity; (2) logistics: integrated and efficient; (3) systems integration & engineering for mission success; (4) technology dominance; (5) resources rationalized; (5) industrial base strengthened, and (6) motivated, agile workforce.

Performance goals for FY 2004 and FY 2005 are listed in the following table, along with a short description of ongoing activities:

**Acquisition Excellence Goals: Activity Indicators**

<table>
<tr><th>Goal</th><th>FY 2003</th><th>FY 2004</th><th>FY 2005</th></tr>
<tr><td>**Acquisition Excellence with Integrity**</td><td>Revised the complex and long-standing DoDD 5000.1 (The Defense Acquisition System) and DoDI 5000.2 (Operation of the Defense Acquisition System). Both were approved for implementation on May 12, 2003. Funded Major Defense Acquisition Programs (MDAPs) to the estimates provided by the Department's Cost Analysis Improvement Group (CAIG).</td><td>Continue efforts to shorten the acquisition cycle time, with an ultimate goal of <99 months, using evolutionary acquisition and spiral development, and maximizing use of mature and commercial technology. Continue direction to fund MDAPs at the CAIG estimate. Transition from "systems-focused" to capabilities-based Defense Acquisition Executive Summary Reviews (DAES).</td><td>MDAP acquisition cycle time goal is still <99 months, MDAP acquisition cost growth goal is 0%. Conduct quarterly capabilities-based DAES reviews. Continue evolutionary acquisition and spiral development efforts to push systems to the warfighter faster.</td></tr>
<tr><td>**Logistics: Integrated and Efficient**</td><td>The goal of 16 days was not met. Customer Wait Time averaged 19 days, primarily due to increase in demand for critical items and delays in closing out Operation Iraqi Freedom transactions.</td><td>Customer Wait Time goal of 15 days. Continue initiatives in enterprise integration business systems and processes, end-to-end management of logistics, support strategies based on performance based logistics.</td><td>Customer Wait Time goal of 15 days. Continue FY 2004 initiatives. Develop budget to support performance based logistics.</td></tr>
<tr><td>**Systems Integration & Engineering for Mission Success**</td><td>New Acquisition, Technology and Logistics goal - not measured in FY 2003.</td><td colspan="2">Conduct various activities to reenergize the systems view of integrated architectures, including the following: Focus our systems integration and engineering activities on mission success: lead development of system views of integrated architectures, integrated plans/roadmaps, and establish mission context for Defense Acquisition Board reviews; foster interoperability, jointness, and coalition capabilities; improve the systems engineering environment; provide professional systems engineering workforce, policies, and tools; and conduct system assessments, assess readiness for Operational Test & Evaluation, and reduce life cycle costs.</td></tr>
<tr><td>**Technology Dominance**</td><td>Goal was to initiate 15 ACTDs. 14 ACTDs actually initiated.</td><td colspan="2">For FYs 2004 and 2005, initiate 15 ACTDs each fiscal year. Continue activities to closely link high payoff science and technology efforts to enhance joint warfighting capabilities and aligning S&T with DoD strategic initiatives.</td></tr>
<tr><td>**Resources Rationalized**</td><td>2005 BRAC process established by SECDEF memorandum.</td><td>Publish BRAC selection criteria; submit report on the 20 year force structure, necessary infrastructure, excess capacity, and certification of the need for a BRAC.</td><td>Revise the FY 2004 report, if appropriate; submit closure and realignment recommendations to Commission and Defense Committees.</td></tr>
<tr><td>**Industrial Base Strengthened**</td><td>Increased competition by stressing that the government no longer expects contractors to invest their own funds for defense research and development to cover shortfalls in government funding. This past practice hurt the ability of contractors to make reasonable profits and discouraged smaller companies from bidding for defense work.</td><td colspan="2">Continue activities to ensure a defense industrial base focused on, and capable of supporting 21st century warfighting. Activities include: establishing organizational cross-feed mechanisms for major industrial base assessments; evaluating industrial sufficiency for key capabilities; developing industrial policy that creates and retains surge capacity for essential materials; and accessing emerging suppliers for innovative solutions.</td></tr>
<tr><td>**Motivated, Agile Workforce**</td><td colspan="3">During FY 2003, continued the Congressionally mandated DoD Civilian Acquisition Workforce Personnel Demonstration (AcqDemo) Project. AcqDemo is designed to give employees a flexible, responsive personnel system that rewards contributions and provides line managers with greater authority over personnel actions. Key features on the demonstration project include streamlined hiring, broad banding, a simplified classification system, and a personnel system that links compensation to employees' contributions to the mission through annual performance appraisals. The Department will be transitioning from the AcqDemo Project to the National Security Personnel System during FY 2004. Additional information on the AcqDemo initiatives is at www.acq.osd.mil/acqdemo.</td></tr>
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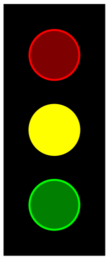
# MANAGE OVERHEAD AND INDIRECT COSTS



*The Defense Department still remains bogged down by bureaucratic processes of the industrial age, not the information age. We are working to change that.*

*Secretary of Defense Donald H. Rumsfeld*
*February 4, 2004*

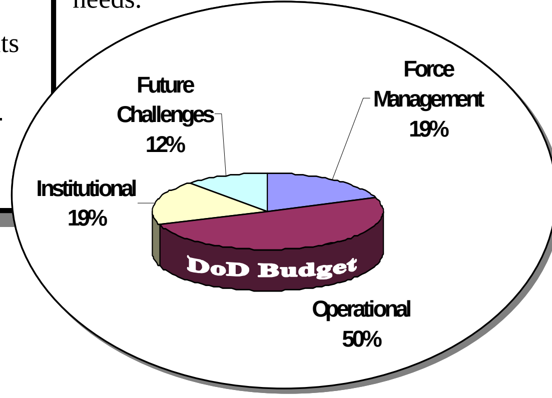
## Link Defense Resources to Key Performance Goals

In FY 2003 we opened a program office dedicated to combining and aligning program and budget databases that had been previously managed separately. We are now engaged in a major review of the Department's program and budget data structure. This review, to be completed during FY 2005, will ensure our common resource management database:

- More directly aligns with Congressional and other external reporting requirements,
- Better support internal business and policy decisions by allowing an overlay of issue taxonomies that support strategy development and reviews, and
- More easily manages data structures and improves our ability to validate data.

This review covers almost 4,000 areas. We will modernize or replace outdated activity definitions, and consolidate or create others. Already we are seeing that today's new strategic approach is merging and blurring the traditional lines between tooth (deployable operational units) and tail (non-deploying units and central support). When the study is complete, we will have a more flexible analysis interface with defense data, allowing us to build alternative ways of mapping our programming data structure and making it easier to crosswalk performance results to resource investments (see table below for an example):

| FORCE MANAGEMENT | OPERATIONAL |
|---|---|
| • **Defense health program:** Medical infrastructure & systems.<br>• **Central personnel administration:** Acquire & administer the workforce<br>• **Central personnel benefit programs:** Family housing programs, commissaries & military exchanges, etc.<br>• **Central training:** Non-unit training from officer training to flight training to military professional & skill training. | • **Expeditionary forces:** Non-nuclear combat units (& organic support) such as divisions, tactical aircraft squadrons, and carriers.<br>• **Deterrence and protection forces:** Operating forces to deter or defeat direct attacks on the United States.<br>• **Communications & information infrastructure:** Secure information distribution, processing, storage & display.<br>•**Other infrastructure:** Management & program support for special-use activities, ranging from navigation to war-gaming to joint exercises. |
| **INSTITUTIONAL** | **FUTURE CHALLENGES** |
| •**Acquisition:** Infrastructure to develop, test, evaluate and manage equipment & systems<br>•**Central logistics**: Supplies, depot-level maintenance, transportation, etc.<br>•**Force installations**: Sustain, restore & modernize facilities at which combat units are based & protect the environment<br>•**Departmental management**: Defense-wide support activities. | •**Other forces:** Intelligence, space & combat-related command, control & communications programs.<br>• **Science & technology program:** Fundamental science relevant to military needs. |

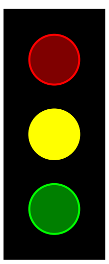



## Reduce Percentage of Budget Spent on Infrastructure

The Department tracks the share of the defense budget devoted to infrastructure as a way to gauge progress toward achieving our infrastructure reduction goals. A downward trend in this metric indicates that the balance is shifting toward less infrastructure and more mission programs. In tracking annual resource allocations, we use mission and infrastructure definitions that support macro-level comparisons of DoD resources.

Although a lagged indicator, this measure offers insights on how to best manage overhead and indirect costs. For example, we estimate that about 44 percent of total obligational authority was devoted to infrastructure activities in FY 2002, down from about 46 percent in the preceding year. The efficiencies reflect results achieved in savings from previous base realignment and closure rounds, strategic and competitive sourcing initiatives, and privatization and reengineering efforts. As we restructure our program and budget databases (see discussion of "Improve the Transparency of Component Submissions," above), we will gain a clearer understanding of the relationship between overhead and direct cost activities to specific capabilities, and thus will be better able to develop mitigation strategies to limit unnecessary growth in overhead.

## IMPROVE THE READINESS AND QUALITY OF KEY FACILITIES



For too long, we neglected our facilities, postponing all but the most urgent repairs and upgrades until the long-term health of our entire support infrastructure was in jeopardy. Therefore, we are investing substantial sums to sustain, restore, and modernize defense facilities worldwide.

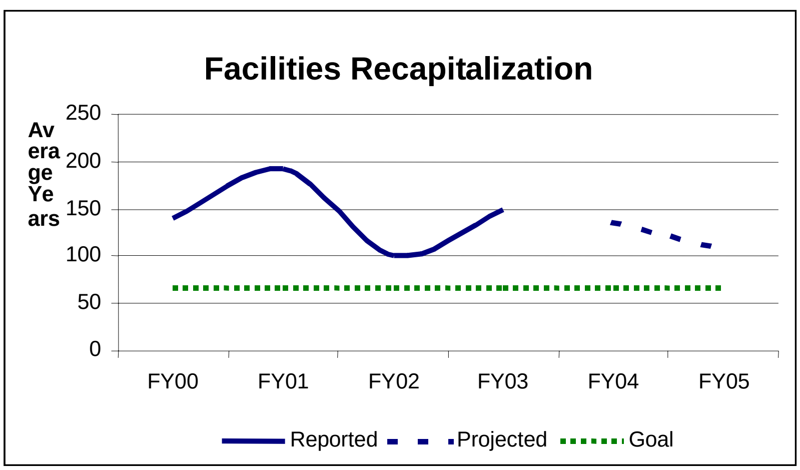
### Fund to a 67-Year Recapitalization Rate

Sustainment covers the basic maintenance or repairs needed to prevent deterioration of facilities, and is the first step in our long-term facilities strategy. The Facilities Sustainment Model (FSM) uses common per-square-foot commercial benchmarks for 400 facility categories, adjusted for local area costs. The Department's goal is to fully sustain (100 percent) of all facilities according to standard benchmarks produced by the FSM. For FY 2003, we budgeted a rate of 93 percent. In FY 2004, we reached 94 percent and our FY 2005 budget improves the rate to 95 percent, an improvement for the fourth consecutive year.

Recapitalization is the restoration and modernization of existing facilities and is the second step in our long-term facilities strategy. The Facilities Recapitalization Metric (FRM) measures the rate at which an inventory of facilities is being "recapitalized"—that is, modernized or restored. Recapitalization may mean a facility has been totally replaced—or incrementally improved over time to meet acceptable standards.

Our recapitalization performance goal is a benchmarked or "normal" average expected service life (ESL) of the overall facilities inventory, estimated to be 67 years in DoD. Actual ESL is a function of how well a facility is sustained, including routine repairs. A "normal" ESL assumes full sustainment that is benchmarked to a commercial per unit cost. (For example, it costs $1.94 per square foot annually to properly sustain a typical aircraft maintenance hanger for a 50-year life cycle.) If a facility is not funded to levels needed to keep it repaired and maintained, its ESL is reduced. Thus, the metrics for sustainment and recapitalization are linked.

We are on a sharp downward slope from our 200+ year FRM average in 1999. Yet, despite the improvements made since 1999, many facilities still report deficiencies serious enough to affect mission performance. During FY 2003, the Department's FRM was 149 years. In FY 2005, the average rate is 107 years. The 2005 budget requests $4.3 billion for facilities recapitalization which, when applied to the currently forecasted facilities inventory, causes us to adjust our estimate of when we can achieve a 67-year rate to FY 2008.



## Restore Readiness of Key Facilities

Rundown facilities are not just uncomfortable places to work, they can generate real military risk if their deficiencies prevent the delivery of important operational services, such as unit training, logistics support, or medical care. The Secretary had directed that all key facilities across the Department be restored to a high state of military readiness. But how do we define and then measure facility readiness?

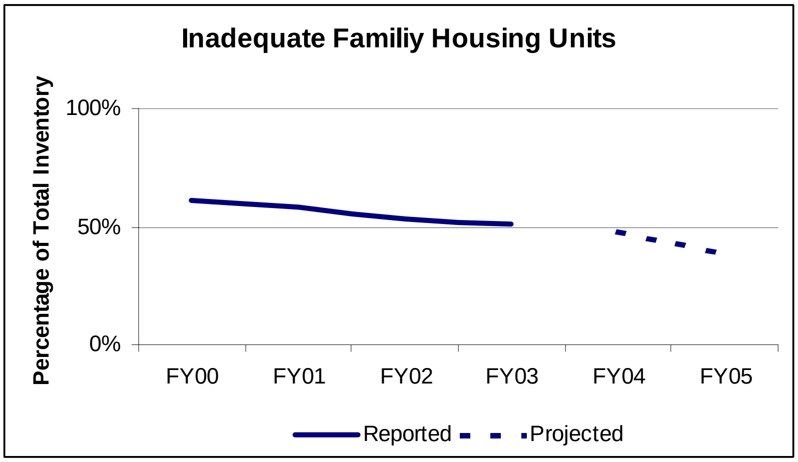
In the past, we've used the Installation Readiness Report (IRR) as an indicator of general conditions. But the current IRR cannot be crosswalked to real property inventories, thus it cannot be used to target investments needed to sustain improvements over the long term.

We need a better set of measures for facility readiness, and have chartered a Department-wide effort under the auspices of the Installations Policy Board to standardize individual facility records in real property inventories, and improve the quality of data underpinning IRR summaries. The first round of improved data is scheduled for receipt in early FY 2005. In the longer term, an enterprise wide real property inventory system is being studied. When implemented, it will replace or improve the three disparate inventory systems with one modern, integrated system.

## Eliminate Inadequate Family Housing

A family housing units is considered "inadequate" if it needs a significant dollar investment to repair (for example, a new plumbing system, new roof or electrical wiring), or is so substandard it needs complete renovation. By the end of FY 2003, over 20 percent of the Department's military housing in the United States had been revitalized and turned over to private developers and property managers to own, maintain, and operate. An additional 20 percent of the housing inventory will be privatized during FY 2004. The Department's goal is to eliminate all inadequate housing by the end of FY 2007. During FY 2005, the Department's performance target is to reduce the number of inadequate family housing units to around 61,000, and reduce the percentage of housing units rated "inadequate" to 38 percent, keeping us on track to eliminate nearly all inadequate family housing in the continental United States by FY 2007 (and FY 2009 for some Air Force installations and overseas bases).

Furthermore, each military department is responsible for developing a Family Housing Master Plan which outlines, by year, how much family housing they currently own, their proposed privatization candidates – and their existing MILCON and Privatization plans to eliminate 90 percent of inadequate military family housing units by FY 2007, and 100 percent by FY 2009.




## Base Realignment and Closure (BRAC)

*We need BRAC to rationalize our infrastructure with the new defense strategy, and to eliminate unneeded bases and facilities that are costing the taxpayers billions of dollars to support.*

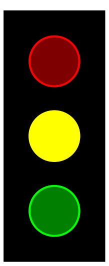
*Secretary of Defense Donald H. Rumsfeld*
*February 4, 2004*

In November 2002, we began to plan for the next round of Base Realignment and Closure (BRAC), as authorized by Congress. Last year, we established the organizational structure that will manage the overall process, and established seven groups to review these common, business-oriented functions across defense: education and training, headquarters and support activities, industrial, intelligence, medical, supply and storage, and technical activities. The military departments will conduct similar reviews of service-unique missions.

This year, we began collecting and certifying the data necessary to compare like defense installations and facilities across a variety of functions. The statute authorizing the BRAC round in 2005 requires that the Department's closure or realignment recommendations be based on a set of selection criteria, a 20-year force structure plan, and an infrastructure inventory. Accordingly, we published the final selection criteria on February 12, 2004 in the Federal Register; the FY 2005 defense budget certified the need for a new BRAC round, and the accompanying justification materials reported the 20-year force structure plan and infrastructure inventory, as well as other BRAC-related information of interest to Congress. By May 16, 2005, we will present to Congress a final set of transformational closure and realignment recommendations.

At the same time, we are proceeding with a global posture review to help us reposition our forces around the world – so they are stationed not simply where the wars of the 20th century ended, but rather are arranged in a way that will allow them to deter, and as necessary, defeat potential adversaries who might threaten our security, or that of our friends and allies, in the 21st century.

## Realign Support to the Warfighter



Transformation of our military forces hinges on being able to reduce redundancy, focus organizations on executive goals, flatten hierarchies, and cut cycle times in the decision and execution processes. If we can find ways to make real progress in these areas, small changes will yield huge gains in technology transfer, which in turn will help drive more effective operational performance.

### Major Defense Acquisition Program (MDAP) Cycle Time

Acquisition cycle time is the elapsed time, in months, from program initiation until a system attains initial operational capability—that is, when the product works as designed and is fielded to operational units. A number of years ago, we began measuring the average cycle time across all major defense acquisition programs, or MDAPs (new equipment or material systems that cost more than $365 million in FY 2000 constant dollars to research and develop, and more than $2 billion to procure and field). We wanted to understand how quickly new technologies were moving from the drawing board to the field. This performance measure is a leading indicator of technology transfer—typically, the faster a program moves toward fielding, the quicker associated operational improvements can be introduced to the force, and the easier it is to control overall program costs.

During the 1960s, a typical acquisition took 7 years (84 months) from initiating program research and development activities to achieving initial operating capability. By 1996 a similar acquisition required 11 years (132 months) from program start to initial operating capability. To reverse this trend, the Department set a goal for reducing the average acquisition cycle time for major defense acquisition programs started since 1992 by 25 percent—to less than 99 months or about 8 years. For those MDAPs started after FY 2001, the Department set a goal of reducing the average cycle time by 50 percent, or to less than 5-1/2 years (66 months). To achieve that objective, the Department is introducing improvements to development and production schedules similar to those initiated for managing system performance and cost.

Preliminary data indicates that the Department achieved an average acquisition cycle time in FY 2003 of about 104 months and 93 months for MDAPs started after FY 1992 and FY 2001, respectively. Actual results will not be available until April 2004. Several programs, including the Black Hawk Upgrade, Land Warrior, and Wideband Gapfiller, were examined and then restructured with more realistic schedule estimates. Although few programs have been restructured, the extensions have affected the average acquisition cycle time. The target for FY 2005 remains fewer than 99 months and fewer than 66 months for MDAPs started after FY 1992 and FY 2001, respectively.

## MDAP Acquisition Cost Growth

Like cycle times, the pace at which acquisition cost increases over time is an indicator of program performance. Acquisition cost growth measures the difference, in percentage, between total acquisition costs estimated in the current-year President's Budget and those estimated in the past-year's President's Budget. The population of programs included in this comparison is all MDAPs common to both budgets—common programs are dollar-weighted.

Although costs can grow for various reasons, including technical changes, schedule slips, programmatic changes, or overly optimistic cost estimates, a steady or downward trend line is a solid indicator of how efficiently acquisition activities are being managed across the Department. We will maintain an annual target of zero percent acquisition cost growth. While this may not be attainable every year, it is the ultimate goal. In the near term, to demonstrate improvement, the Department is aiming for downward trends from year to year. Our actual experience demonstrates a favorable (downward) trend; however, the projected FY 2003 result of 4 percent is based on preliminary data. This is a lagging indicator; actual results will not be available until later in 2004.

## MDAP Operating and Support (O&S) Cost Growth

We are developing a measure similar to the one above to monitor O&S cost growth. This new measure will monitor the growth in O&S costs—that is, the projected costs of people and material required to operate and maintain systems. It will compare the difference, in percentage, between estimates of O&S costs associated with the current-year President's Budget and those estimates done for the past-year's budget. This measure will be an indicator of how effective our efforts are at designing systems that cost less to support and operate. This indicator, when combined with the performance indicator for acquisition cost growth, will represent the entire lifecycle cost of a typical new defense acquisition, like a new tactical jet fighter.

Our goal is to effect a downward trend for O&S cost growth, toward an ultimate goal of zero cost growth. This is a developmental, lagging performance indicator. The first data point was developed in April 2003; the second data point will be available later in 2004.

## Logistics Balanced Scorecard

Response time is a commonly used business measure for evaluating whether an organization's logistics operations are organized to deliver effective, efficient performance. DoD adapted this best-practice to military logistics in FY 2001, when we began measuring the elapsed time from a customer's order to receipt. At that time, we developed the Customer Wait Time metric, or CWT, to track orders filled from assets on hand at the customer's military installation or naval vessel or through the DoD wholesale logistics system. Military services and the Defense Logistics Agency agreed, through the DoD Customer Wait Time Committee, to implement initiatives that would reduce DoD-wide CWT by one day per year from the FY 2001 baseline of 18 days.

Preliminary data indicates that during FY 2003, the average DoD-wide CWT was 19 days—the goal was 16 days. Indications are that the DoD goal was not met due to the increase in demand for critical items and delays in closing out transactions associated with the execution of Operation Iraqi Freedom. The CWT target for FY 2005 will remain at the FY 2004 target of 15 days as long as operations in Iraq continue.

CWT is a transformational approach to evaluating performance. In the past, good logistics meant holding large inventories—today, all the military services have agreed on a common set of business rules for monitoring the performance of the entire logistics enterprise. Therefore, we are in the process of developing a Logistics Balanced Scorecard to define key parameters of the responsiveness of the logistics supply chain, and to measure and monitor actual performance. This scorecard will be completed in FY 2005, and will focus on the full range of logistics activity, and measure performance in terms of specific operational missions. Eventually, measures developed in support of this scorecard can be used to inform the operational and contingency planning process.

We are exploring ways logistics supports the warfighter, by developing measures of our ability to support current operations, such as the percentage of material or services provided in theater by a specified date. By reviewing how orders are filled (right product to the right place, correct condition and packaging, etc.), we can gauge how accurately we are meeting meet customer needs for products and services.

During FY 2003 we identified an initial set of candidate metrics and data sources. This year we will develop a baseline and targets for some metrics, and begin results through the Joint Logistics Board. During FY 2005, we begin verifying and expanding the use of scorecard metrics, and move to an automated tracking system.

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